Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Klehs	Analyst:	Anne Mazur	Bill Number:	AB 673
Related Bills:	See Legislative History	Telephone:	845-5404	Amended Date:	January 4, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT:	Petroleum Windfall Profits Penalty

SUMMARY

This bill would impose a penalty on windfall profits realized by petroleum producers and refiners.

SUMMARY OF AMENDMENTS

The January 4, 2006, amendments deleted provisions that would have amended the Labor Code and added provisions that would amend the Revenue and Taxation Code to establish a petroleum windfall profits penalty, as described in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

It appears this bill is intended to disgorge large profits oil companies made in the wake of disasters such as Hurricane Katrina.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would take effect immediately upon enactment. The bill provides that it would specifically apply to taxable years beginning on or after January 1, 2005, and before January 1, 2008.

POSITION

Pending.

Board Position:			Department Director	Date
________ S	________ NA	________ NP	Will C. Bush	12/30/05
________ SA	________ O	________ NAR		
________ N	________ OUA	____X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Prior federal law in effect from 1980 to 1988 imposed an excise tax on certain oil windfall profits. The tax rate ranged from 15% to 70% of the difference between the market price of oil and a predetermined base price. Currently, there is no federal tax on oil windfall profits; however, there are numerous proposals under consideration in both houses.

California has not imposed a state-level windfall profits tax.

THIS BILL

This bill would establish the Petroleum Windfall Profits Penalty in an amount equal to 2.5% of the windfall profits realized by petroleum producers and refiners. Taxpayers would be subject to the penalty if they are engaged in the business of petroleum production or refining as described in designated codes of the 2002 edition of the North American Industry Classification System Manual (NAICS), i.e., Codes 211 and 32411 for petroleum producers and petroleum refiners, respectively.

"Windfall profits" would be defined as adjusted net income over base year net income. "Adjusted net income" would mean business income apportioned to California before any net operating loss (NOL) deduction. The base year adjusted net income would be a moving average of the taxpayer's business net income before NOL deductions for the five preceding years.

The bill would provide FTB with the authority to prescribe rules and regulations to implement the provisions of the bill, including any rules to take into account mergers, acquisitions, and divestitures in the computation of the base year adjusted net income.

The bill specifies that the penalty would apply to taxable years beginning on or after January 1, 2005 and before January 1, 2008. The bill also provides that the provision would be repealed on January 1, 2009.

IMPLEMENTATION CONSIDERATIONS

Department staff is available to work with the author's office to resolve implementation concerns that may be identified as the bill moves through the legislative process.

LEGISLATIVE HISTORY

ABX 128 (Corbett and Wiggins, 2001/2002) and ABX2 2 were identical. These bills would have imposed a tax on excess gross receipts from electrical energy distribution and required electricity purchasers to withhold and remit the tax. SBX 128 was held in the Assembly Appropriations Committee. ABX2 2 failed passage on the Assembly floor.

SBX 1 (Soto, 2001/2002) and SBX2 1 (Soto, 2001/2002) would have imposed an Electricity Windfall Profits Tax on sellers of electricity and would have refunded the amount collected to individuals that filed a tax return. SBX 1 died in the Assembly when the first extraordinary session ended. SBX2 1 failed passage on the Assembly floor.

SB 14 (Thompson, 1995/1996) and SB 1777 (Burton, 1999/2000) would have imposed a Petroleum Windfall Profits Tax on certain taxpayers engaged in petroleum refining. SB 14 failed passage in the Assembly Revenue and Taxation Committee. SB 1777 was held in the Senate Rules Committee.

There are currently numerous federal bills proposing some form of windfall profits tax on integrated oil companies—i.e., those companies involved in production, refining, and marketing. Some of these proposals include provisions to rebate the taxes collected to certain consumers.

OTHER STATES' INFORMATION

Florida, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws do not have windfall profits taxes or penalties. The laws of these states were reviewed because their laws are similar to California's income tax laws.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns are identified and resolved, but could be significant if an additional line is added on all tax returns to capture the penalty data. An additional line could require new system programming, forms design, and forms printing.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The revenue impact of this bill, under the assumptions discussed below, would result in the following gains:

Revenue Impact of AB 673 Enactment Assumed After June 30, 2006 in millions		
2006-07	2007-08	2008-09
+$140	+$70	$0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Micro-level data on a sample of California petroleum producers and refiners were used to estimate the revenue impact of this proposal. The incomes of these taxpayers were projected into the future using financial information from public-domain sources and expert judgment. A penalty of 2.5% was then applied to the excess of income in any taxable year over the average of the incomes for the five immediately preceding taxable years. Staff assumed that this proposal would be enacted sometime after June 30, 2006.

For the 2005 tax year, the income for California petroleum producers and refiners is forecast[1] to be approximately $6.9 billion. The 2005 gross base year adjusted net income is forecast to be approximately $3.3 billion. The estimated "windfall profits" are, therefore, approximately $3.6 billion. Multiplying the "windfall profits" by the 2.5% penalty rate generates a revenue gain of approximately $90 million. As noted below, penalty payments attributable to 2005 would not be due until sometime in the 2006-07 fiscal year. Both penalty payments attributable to taxable year 2005 and attributable to taxable year 2006 would be realized in the 2006-07 fiscal year.

For purposes of this estimate, department staff assumed the following:

- The penalty payment would be due on the date prescribed for paying tax (generally the original due date of the return), unless the due date occurs before enactment of this bill. In that case, the payment due date would be some date on or after the enactment date.
- No estimated tax penalties would be assessed.
- This bill will be amended to expressly provide for each of these items.

LEGAL IMPACT

The windfall profits penalty could be considered an indirect price regulation. The Federal Energy Regulatory Commission regulates only a segment of the industry, namely oil pipelines. However, this could be viewed as preempted by federal laws or regulations, and thus unconstitutional.

ARGUMENTS/POLICY CONCERNS

The author may want to consider applying a growth factor to the base year adjusted net income. The current language provides for the base year to be determined by reference to an average of business income apportioned to California over the five immediately preceding taxable years. While such a method has the effect of smoothing peaks and valleys in earnings, it can result in application of the penalty to what might be perceived as normal, in addition to windfall, profits.

This bill could be viewed as inequitable as it would impose a penalty on large profits reported by a single industry that already is subject to state taxation to the extent income is derived from California sources.

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[1] Projected income for 2005 is based on data published in The Value Line Investment Survey.